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DEPT PASS TO TREASURY FOR OFFICE OF SOUTH ASIA MNUGENT
TREASURY PASS TO FRB SAN FRANCISCO/TERESA CURRAN
USDA PASS FAS/OCRA/RADLER/BEAN/CARVER/RIKER
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SUBJECT: NEW DELHI WEEKLY ECON OFFICE HIGHLIGHTS FOR THE WEEK OF
March 2 TO March 6, 2009

NEW DELHI 00000435 001.2 OF 006

¶1. (U) Below is a compilation of economic highlights from Embassy New Delhi for the week of March 2-6, 2009, including the following:

-- India Continues to Slow Down
-- Inflation Declines to 7-Year Low; RBI Moves
-- FDI Clarifications Just Cloud the Issue
-- FATF Gives Go Ahead for India Mutual Evaluation
-- Embassies Discuss New International Worker Provisions
-- Fate of Unfinished Economic Legislation

-- Verizon gets approval for its own internet gateway in India
-- Reliance Petroleum Re-acquired by RIL, Chevron Sells Its 5% Refinery Stake
-- India Amends Chinese Toy Ban to Allow Imports With Safety Certification
-- India's Exports Continue To Decline
-- IBM Reportedly a Frontrunner for Satyam Purchase
-- SEZs Will Get Tax Refunds on All Input Services
-- GOI Appoints Chairman of Competition Commission
-- GOI Takes Steps to Lift Wheat Export Ban

India Continues to Slow Down

¶2. (SBU) India's GDP slowed down to a six-year low of 5.3 percent in the third quarter of FY 2008-09 (October-December 2008). The lower-than-expected growth was largely due to a significant drop in Agricultural GDP growth rate to(-)2.2 percent from +6.9 percent during the corresponding quarter of FY 2007-08 due to a significant decline in production of fall-harvested crops, mainly coarse grains, oilseeds, pulses, cotton, and sugar cane, due to erratic rainfall and high base effect. Contraction in the manufacturing sector by 0.2 percent also contributed to the lower output. Nevertheless, the services sector, which accounts for over 57 percent of GDP, remained buoyant at 9.9 percent largely due to the Sixth Pay Commission outgo. Sectors such as social community and personal services grew by a robust 17.3 percent during the period. Cumulative GDP growth

during April-December 2008 works out to 6.9 percent as compared to the government estimates of 7.1 percent growth for the full fiscal year. Subir Gokarn, Chief Economist of Standard and Poor's Asia Pacific, estimates that an expected weaker fourth quarter performance will take the full FY 2008-09 growth rate down to the range of 6-6.5 percent, in line with many projections. To achieve a 7 percent growth this fiscal, the economy needs to grow by at least 7.6 per cent in the January-March quarter, which seems unlikely, given the weakening global environment.

Inflation Declines to 7-Year Low; RBI Moves

¶3. (SBU) India's wholesale price inflation (WPI) hit a seven-year low of 3.03 percent for the week ended February 21 (versus 5.69 percent in the corresponding week a year ago), due to lower prices of food items and select manufactured items, such as metals and transport equipment. Lower prices of some food items, such as rice, wheat, pulses, vegetables and edible oils, also contributed to the fall. WPI inflation is expected to fall at an even faster rate in the next two weeks due to the base effect. Retail inflation as measured by the Consumer Price Inflation (CPI) for industrial workers hit an 11-year high of 10.45 percent in January from 9.7 percent in December. The Reserve Bank of India expects retail inflation to also fall and at a much sharper rate due to the declining trend in the WPI of food items.

¶4. (SBU) The continuing decline in inflation has provided the central bank, the RBI, with more policy room to enact further interest rate reductions and indeed it announced 50 basis point reductions in both of its main policy rates, the repo and reverse repo rates. The repo rate, at which the central bank lends to banks, has been lowered to 5%, while the reverse repo rate, the rate at which the RBI pays interest on funds that banks keep with it, was lowered to 3.5%. Mumbai will report more septel.

FDI Clarifications Just Cloud the Issue

¶5. (SBU) Econoff attended a panel discussion on March 5, hosted by AmCham and led by analysts at PwC, Ernst & Young, Deloitte Touche and KPMG, regarding the Ministry of Commerce's recent issuances of "Press Note" guidance on foreign direct investment (FDI). There was no real consensus among the panelists of the intent and implications of the press notes, although the panelist for Ernst & Young pointed to language in the press note that it was issued to address concerns for needed investment capital within already-permitted FDI sectors. Several in the audience - a combination of foreign firms and local accountants - agreed that the press notes were not intended to open up previously restricted areas of investment. Some raised concern that the confusion surrounding the press notes might deter new investors altogether. AmCham noted that it was putting together a memo of concerns for the Ministry of Commerce, which the Secretary covering investment policy had requested. Given the politicized nature of some investment areas and imminent elections, however, many expected there will be no further clarification until a new government is formed in June.

FATF Gives Go Ahead for India Mutual Evaluation
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¶6. (SBU) Just days after India's Parliament passed key amendments to its Prevention of Money Laundering Act (PMLA), the biennial plenary of the multilateral Financial Action Task Force (FATF), agreed that India's mutual evaluation on-site visit should be scheduled for sometime later this year. India had earlier requested a mutual evaluation, which FATF uses to measure a country's framework to combat terrorist financing and anti-money laundering (AML/CFT). The FATF Secretariat will coordinate with the Indian authorities regarding scheduling -- the on-site will likely take place in the last quarter of 2009. It will be a joint evaluation by FATF and the Asia Pacific Group (APG), a regional body, with FATF as the lead.

Embassies Discuss New International Worker Provisions
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¶7. (SBU) Econoff attended a meeting with economic officers from the Embassies of Germany, France, Australia, United Kingdom, South Korea and Japan on February 25 to discuss the impact on foreign workers and companies of India's new category of "international worker." Under the new designation, foreign workers must pay in 12% of their income to India's Employee Provident Fund, while employers must do the same. The new category does not apply if the foreign worker's home country has a "social security totalization agreement" with India, which exempts workers from each country from paying into the host country's social security system.

¶8. (SBU) Germany noted that it had signed a "posting agreement," which exempt Indian workers in their countries from paying social security, but fall shorts of a full totalization agreement. France indicated that they have signed a full social security agreement with India, but it has not yet been ratified. The officers noted, with some exasperation, that since their current agreements are not yet ratified, they do not exempt their workers from falling under the new "international worker" agreement. France and Germany noted that their capitals were still determining what, if anything, they might do in response to the new category. In the meantime, the German representative (their Counselor for Social and Labor Affair) stated his understanding that Germany would still go ahead with plans to ratify and implement the current agreement and even expand it to a full totalization agreement by Spring 2010. The French officer did not know when their bilateral agreement might be ratified. Korea noted that his country had a modest reciprocal agreement with India, and that the current draft of a bilateral Comprehensive Economic Cooperation Agreement (CECA) included a paragraph on the Employee Provident Fund. The rest of the Embassies indicated they did not have any bilateral worker agreements with India, although Australia said that Canberra had agreed late last year to enter negotiations on a social security agreement with

India, partly in response to the new worker requirement.

Fate of Unfinished Economic Legislation

¶9. (SBU) When Parliament ended its session on February 26, 37 Bills were pending in the Upper House of Parliament (Rajya Sabha). Because the Upper House of Parliament technically is a permanent body, bills introduced in this house do not lapse. The key pending economic bills introduced there are: the Insurance Laws (Amendment) bill 2008, which would increase the foreign direct investment cap to 49 percent from 26 percent; the Foreign Contribution (Regulation) Bill 2006 designed to more effectively check the use of foreign funds for subversive activities by terrorist and anti-national organizations; the Mines and Minerals (Development and Regulation) Amendment Bill 2008 which will allow state governments to grant a prospecting license/mining lease for coal and lignite to private companies through auction by competitive bidding; and the Coal Mines Nationalization (Amendment) Bill 2008, which provides for mining of coal by the private sector (including foreign firms) to ease the demand-supply situation. Bills which are pending with the Rajya Sabha can be considered and passed as it is, as most of the pending bills are already with the Standing Committee of Finance and their reports are ready. However, it is also possible that the new government may make minor changes in some of the clauses of the bills.

¶10. (SBU) Constitutionally, bills introduced in the Lower House of Parliament (Lok Sabha) lapse at the end of the Lok Sabha term. Some of the important financial sector bills that lapsed on February 26 include the Banking Regulation (Amendment) Bill 2005 which would have increased the voting rights for foreign stakeholders in private banks; the Pension Fund Regulatory and Development Authority Bill (PFRDA) 2005 for pensions sector reforms; the Forward Contracts (Regulation) Amendment Bill 2008 bill for improving the commodities market; the Micro Financial Sector (Development and Regulation) Bill aimed at enabling more loans to the poor; the State Bank of India (Amendment) Bill, 2006, which would have allowed the Sate Bank of India to access the capital market and allow the Reserve Bank of India to reduce its equity; the State Bank of India Subsidiary Laws (Amendment) Bill 2009 which could empower the government to increase

or reduce the capital of a subsidiary bank; and the Life Insurance Corporation of India (LIC) (Amendment) Bill 2008 which would increase the paid-up capital of the state-owned LIC. Bills which have lapsed in the Lok Sabha will have to be reexamined by their respective ministries and then reintroduced in Parliament. Lapsed bills may even be abandoned, depending upon which government and coalition comes into power and their objectives and commitments.

Verizon gets approval for its own
internet gateway in India

¶11. (SBU) New York-based Verizon Communications has received approval from the GOI's Department of Telecommunications to operate international "gateways" in Mumbai and Chennai. Verizon India's General Manager told Consulate General Chennai that this approval will allow Verizon to have greater control of its international network capacity into and out of India and will allow it to better monitor end-to-end network performance and product delivery.

¶12. (SBU) Verizon will now be able to offer a greater and more dependable array of integrated communications, information technology, and security solutions to its major customers in India, which include Ford, Motorola, Oracle and Caterpillar. Verizon can now more directly link its customers to the 19,000-kilometer Southeast Asia-Middle East-Western Europe-4 (SEA-ME-WE-4) undersea cable at both points where it comes ashore in India (near Chennai and Mumbai). (SEA-ME-WE-4 serves as the main "internet backbone" between Southeast Asia, India, the Middle East, and Europe.) The approval will also allow Verizon to connect to the Europe India Gateway (EIG), a submarine cable linking the UK and India via several points in Europe and the Middle East currently under

construction, due for delivery in 2010.

Reliance Petroleum Re-acquired by RIL, Chevron
Sells Its 5% Refinery Stake
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¶13. (U) Chairman Mukesh Ambani's Reliance Industries Ltd (RIL) decided March 2 to re-acquire refinery giant Reliance Petroleum Ltd (RPL) to create the world's largest refining capacity at a single location (Jamnagar, Gujarat) and the world's fifth largest polypropylene manufacturer, with RPL shareholders getting one share of RIL for every 16 shares of RPL held. RPL commissioned its export-oriented 580,000-barrel-per-day (bpd) refinery in December 2008, located next to RIL's 660,000-bpd refinery in Jamnagar, so the combined firm will have 1.24 million bpd refining capacity. RIL has oil and gas production capacity and is bringing on new natural gas production in southeast India's Krishna-Godavari offshore basin. RPL was de-merged from RIL in January 2006. U.S. oil and gas giant Chevron then picked up a 5% stake in the RPL in April 2006 for US$ 295 million, just before RPL's public listing that May. Chevron had an option to either increase its share in RPL by another 24 percentage points to a 29% stake by June 2009 or to sell its 5% stake. Chevron had envisioned sharing RPL's capacity in order to sell refined petroleum products and petrochemicals in the Middle East and other parts of Asia.

¶14. (SBU) -- Business Proprietary) Given the plunge in world oil prices and refined products demand, and even though RPL share prices have also dropped -- Chevron decided against increasing it share in India's refinery capacity and opted to sell its 5% RPL stake for USD 300 million. RIL will have 70% ownership of RPL, which will reach 75.38% with the purchase of Chevron's share, and Mukesh Ambani will be chairman of both RIL and the RPL subsidiary. Moreover, RIL's acquisition of RPL means that even an expanded Chevron stake in RPL would have translated into only a small fraction of total ownership of RIL.

India Amends Chinese Toy Ban to Allow Imports
With Safety Certification

¶15. (U) India amended the prohibition against imports of Chinese toys on March 2, 2009. In place of a complete ban on certain Chinese toys, the GOI imposed product safety standards conforming to standards prescribed by safety bodies such as the International Organization for Standardization (ISO) or the American Society for Testing and Materials (ASTM). Commerce Ministry officials have told media that the imports will have to be accompanied by certificates from laboratories accredited to the International Laboratory Accreditation Cooperation.

¶16. (U) India announced the six-month ban on January 23, 2009, prompting trade frictions between the two countries. The PRC government warned that "bilateral trade relations could be seriously impacted" and urged India to take "cautious and prudent trade remedy measures" at a time when "the world economy faces grim challenges". Amid the global slowdown, Commerce Minister Kamal Nath has emphasized several times that "New Delhi opposes any form of trade protectionism".

¶17. (U) Chinese toys such as dolls, cars, trains and puzzles make up more than half of India's $500 million toy market and the ban sent prices of toys soaring in local markets as imported supplies declined. Some Indian analysts had viewed the ban as a protectionist measure for the local struggling toy industry, which employs about two million workers. Media report that Indian toy industry epresentatives have admitted a lobbying effort for the increased protection. The certification requirement may act as a non-tariff barrier to imports.

India's Exports Continue To Decline

¶18. (U) India's export performance continues to decline, a trend first witnessed with the October 2008 export figures. Final GOI figures for January 2009 show a 16 percent drop in merchandise exports to $12.7 billion from $14.7 billion from the previous year's period. In addition, according to preliminary data released this week, February exports dropped 13 percent to $13 billion, bringing cumulative exports for the 11-month period of the Indian fiscal year (IFY ending March 30) 2008-09 to $157.3 billion compared with $142.8 billion in the corresponding period of IFY 2007-08. India's exports grew 31 percent in the first half of the IFY 2008-09; but have turned negative since October 2008 to coincide with the financial crisis in its main destination markets. The monthly export data for IFY 2008-09 depict decelerating trends immediately after the first month (April 2008) when export growth peaked at 45.7 percent. Barring June 2008 with export growth of 38.4 percent, all other months of IFY 2008-09 witnessed either a declining or negative trend. The GOI revised its export target for IFY 2008-09 to $170 billion from the original target of $200 billion.

¶19. (U) Another significant trend witnessed in the recently released GOI trade data is the slump in import growth, suggesting the impact of the slowdown on Indian industrial activity, coupled with declining commodity prices. In January 2009, imports fell for the first time in IFY 2008-09, declining by 16 percent to $12.4 billion from $14.7 billion in the year earlier period. Preliminary estimates show that imports fell 18 percent in February 2009. The overall import data for the first eleven months of IFY 2008-09, however, still reflect a 21 percent increase to $260.4 billion. Monthly data indicate impressive growth pattern in imports until September 2008, after which the growth numbers started heading downwards, and finally turned negative in January 2009. Apart from lower demand, the price effect of a fall in crude oil prices also depressed India's import figures.

¶20. (U) Delhi Exporters Association spokesperson has said that small and medium exporters have been worst hit by the prevailing economic slowdown, and many - mostly in the handicrafts, garments, leather goods, and jewelry - have already shut down their businesses. Despite three stimulus packages announced over the last three months by the GOI, Indian exporters find no hope of revival in export activity in the short term.

IBM Reportedly a Frontrunner for Satyam Purchase
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¶21. (U) A prominent business daily has reported that the global IT giant IBM has begun discussions with India's Satyam government-nominated board to acquire a majority stake in the company. A team of investment bankers and lawyers from the US and Europe has reportedly been brought in to conduct due diligence. IBM declined to comment on the rumors. Other interested companies reportedly in the race to acquire Satyam are Larsen & Toubro (L&T, already owning 12 per cent in Satyam) and B.K. Modi's Spice group.

SEZs Will Get Tax Refunds on All Input Services
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¶22. (U) In a bid to clear ambiguity in service tax exemption to special economic zones (SEZs), the Government of India (GOI) on March 3, 2009, notified a rule change allowing refunds for taxes paid on all input services, regardless of whether the services are used inside or outside the tax-free zones (http://www.servicetax.gov.in/servtax_notfns_ idx.htm). SEZ developers and unit owners have been demanding a tax exemption on services consumed outside the export zone if the services were related to production within the zones. In accordance with the new rules, developers and SEZs will have to first pay the tax on the services and then claim a refund from the tax authorities within six months. Until now, the SEZs were exempted from paying a tax on services used inside the zones while services used outside the zone were taxed at 10 percent with no refunds. While the GOI views this

move as helping the finances of SEZ developers and companies operating inside SEZs, exporters have reportedly voiced their concern regarding the increased paperwork and transaction costs imposed by the refund process.

GOI Appoints Chairman of Competition Commission
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¶23. (U) After months of speculation after the resignation and retirement of Acting Chairman Vinod Dhall of the Competition Commission of India (CCI), the GOI this week appointed Dhanendra Kumar as the new Chairman. Kumar, who most recently served as an Executive Director at the World Bank, is a retired Indian Administrative Service (IAS) Officer. The CCI leadership will comprise of a Chairman and five members. Two of the members, former Ministry of Coal Secretary Harish Chandra Gupta and former Chairman of the Central Board of Direct Taxes (CBDT) R. Prasad, have started working at CCI while two others have been appointed but not formally assumed office, including Geeta Gouri and Prem Narayan Parashar. Gouri is a member of the Electricity Regulatory Commission in Andhra Pradesh and Parashar is a lawyer and member of the Income Tax Appellate Tribunal. The final member has yet to be nominated. These appointments are viewed as a positive move towards establishing a functioning anti-trust regulatory body in India.

GOI Takes Steps to Lift Wheat Export Ban

¶24. (U) An Empowered Group of Ministers (EGOM) - an intra-Cabinet political decision-making body - agreed in principle to lift the two-year old ban on exports of wheat and wheat products after national elections in May. The February 2007 ban was instituted during a period of rising inflation. However, now faced with ample domestic stocks and declining inflation, the EGOM decided to unofficially move forward with lifting the ban. The government is barred from making major policy decisions within two months of a general election by an Election Commission code of conduct, thus the 'unofficial' nature of the proposed change. Unnamed Food Ministry sources indicated that a notification would be issued after May, with a group of secretaries in various ministries working out the details of the policy in the interim. Analysts feel India will find it difficult to export wheat without an export subsidy given the drop in international prices and the fact that the GOI has set a high minimum support price (MSP) for procuring wheat from Indian

farmers. The high MSP led to heavy wheat planting, which was one of the main reasons for a strong wheat harvest last year. Prospects for another strong summer (rabi) crop in May will increase stocks further. USDA/FAS, in a January GAIN report, noted the likelihood of the export ban being rescinded after the rabi harvest, and further emphasized that India was only capable of exporting with a subsidy given the high MSP.

¶25. (U) Visit New Delhi's Classified Website:
http://www.state.sgov/p/sa/newdelhi

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